



# ***Solutions to Improve the Liquidity and Creditworthiness of the U.S. Energy Industry***

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Clearing & Other Solutions***

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# Post-Enron Credit and Liquidity Crises

## ➤ Post-Enron Credit and Liquidity Crises

- Lack of uniform and standardized contracts, contract terms, and delivery points has made it difficult to fully commoditize energy supplies as well as the risks associated with energy production, transportation and delivery
- Non-scientific, non-verifiable settlements and indices that determined financial results of billions of dollars of transactional values
- Few liquid trading hubs in which physical delivery of natural gas and electricity can occur



# Solutions to the Post-Enron Credit and Liquidity Crises

- **June 2002 - NEM Risk Valuation, Management and Financial Accountability Taskforce - “Energy Market Stability Framework” Strawman**
- **February 2003 - NEM Clearing, Netting and Settlement Taskforce - “Solutions to Improve the Liquidity and Creditworthiness of the U.S. Energy Industry”**
- **2003 - NEM Risk Management, Disclosure and FASB 133 Implementation Taskforce examining development and implementation of a generally accepted, neutral, standardized, credible, transparent and auditable, short-term and long-term valuation tool, based on indices and/or market transactions**



# Solutions to the Post-Enron Credit and Liquidity Crises

- **The trading platforms, clearing functions and risk management expertise of NEM members and the use of the NEM/EEI Master Netting Agreement could be the silver bullet the industry has been seeking to reverse the crisis of confidence and bring much-needed price transparency, liquidity, more secure creditworthiness, and reliable marks back into the energy market**
  - **Historical databases of transactional data to provide credible pricing information to use for mark-to-market accounting (Prebon Yamane and Amerex)**
  - **Clearing and clearing-type solutions to reduce counterparty credit risk while freeing up much-needed liquidity for trading (EnergyClear Corporation, Guarantee Clearing Corp./London Clearinghouse (ICE), The New York Mercantile Exchange, and Virtual Markets Assurance Corporation)**
  - **Expertise in areas of risk management, software solutions, capital adequacy and accounting issues (Lodestar, Excelergy, SPi Group, Caminus, FEA, KWI, and Deloitte & Touche)**



# Clearing, Netting and Settlement Solutions

## ➤ **Benefits of Clearing, Netting and Settlement Solutions**

- **Reduction of risk by netting the obligations of buyers and sellers**
- **Mutualization of insolvency risk**
- **Significant reduction in the amount of capital necessary to trade or hedge future energy production or consumption**

## ➤ **Costs of Clearing, Netting and Settlement Solutions**

- **Margin requirements and transaction fees - only a fraction of capital exposure needed to back a bilateral transaction**

## ➤ **Implementation Issues Associated with Clearing Solutions**

- **Degree to which risk is mutualized across members differs for each clearinghouse**
- **Transparency of clearinghouse rules and bylaws, e.g., extent to which risk of customers or members is assessed**
- **Extent of protection afforded in the event of default or bankruptcy - bankruptcy laws may need to be amended to permit multiparty netting by private contract**



# Promoting Liquidity and Creditworthiness in the Market - Standard Competitive Market Designs

- **Issues that Require Standard Competitive Market Designs**
  - **Standard Wholesale Market Design and Transmission Service**
    - **Ensure large, highly standardized RTOs/ITPs - allowing regional variations will create seams and arbitrage opportunities**
  - **Credit, Liquidity, Risk Valuation and Management**
    - **FERC/CFTC/SEC Jurisdictional and Reporting Issues**
    - **FASB 133/Mark-to-Market Accounting Issues - creation of standardized, credible, transparent and auditable price indices**
    - **OTC Trading and Derivative Issues**
  - **Commercial and Reliability Rules and Practices**
    - **NAESB/NERC/FERC**
    - **Retail/Wholesale/Gas/Electric**
    - **Standardized Electronic Data Protocols**